



**IOWA CORPORATE**  
CENTRAL CREDIT UNION

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March 30, 2009  
Ms. Mary Rupp  
Secretary of the Board  
National Credit Union Administration  
1775 Duke Street  
Alexandria, VA 22314-3428

Re: Response to Advance Notice of Proposed Rulemaking (ANPR) for Corporate Credit Unions

Dear Ms. Rupp:

Iowa Corporate Central Credit Union (Iowa Corporate) thanks the NCUA Board for the opportunity to comment on the ANPR for Corporate Credit Unions. As background, Iowa Corporate is a \$100 million institution that serves approximately 146 credit union members primarily in the state of Iowa.

The concept of restructuring the Corporate Network and its business model is not a new concept and recent economic events have brought more light to the need for reexamination of the network. The unprecedented economic downturn causing the current credit and liquidity crisis prompted actions by the NCUA. The actions taken by the NCUA were designed to address liquidity, capital needs, and member confidence. The most recent of NCUA's actions is an open forum for the gathering of information and ideas from the credit union industry through the formal process of issuing an Advanced Notice of Proposed Rulemaking and Request for Comment (ANPR).

Credit Unions did not create the current financial crisis but have certainly been impacted. As an industry we need to work together to ensure the longevity of credit unions long into the future by acting with great consideration and diligence when examining potential changes to the Corporate Network. The new regulation must establish rules that promote safety and soundness but can not take away the Corporate's ability to be competitive in the marketplace and to add the best value to member owners.

The ANPR addresses several key issues affecting the Corporate Network that could significantly redefine the Corporate charter. Iowa Corporate's management and board of directors have prepared the following responses to the issues raised in the ANPR.

## **1. THE ROLE OF CORPORATES IN THE CU SYSTEM**

### ***ANPR Issue Description and Questions***

*Recent events have highlighted structural vulnerabilities in the corporate credit union system. NCUA is considering whether comprehensive changes to the structure of the corporate system are warranted. Possible approaches the agency is considering include eliminating the second or wholesale tier from the corporate system, modifying the level of required capital, isolating payment services from the risks associated with other lines of business, determining which product and service offerings are appropriate for corporates, requiring a restructure of corporate boards, and tightening or eliminating the expanded investment authority that is currently available to corporates.*

*Payment systems. Some of the questions and issues arising in this context, on which the Board is seeking comment, include matters such as whether payment system services should be isolated from other services to separate the risks. If so, what is the best structure for isolating these services from other business risks? Specific comment is solicited concerning whether, for example, it would be better to establish a charter for corporate credit unions whereby a corporate's authority is strictly limited to operating a payment system, with no authority to engage in*

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other services, such as term or structured investments. Additionally, a separate charter may be available for corporate credit unions that want to engage in providing investment services. Another alternative would be for NCUA to establish distinct capital requirements for payment systems risk and the risks of other corporate services. NCUA could also require that a legal and operational firewall be established between payment system services and other services. In connection with this topic, comment is also sought on the question of whether there is sufficient earnings potential in offering payment systems to support a limited business model that is restricted to payment systems services only.

**Liquidity and liquidity management.** Historically, the primary role of corporate credit unions has been to provide and ensure liquidity. Corporate investments were made with an eye towards ensuring funds would be available (or used as collateral for borrowings) to meet members' short-term liquidity needs. Recent events underscore the need to assure a corporate properly considers its investment position relative to its cash flow needs. The Board recognizes and understands that providing liquidity for the credit union system is one of the principal purposes of the corporate credit union network. One question for consideration and comment is whether liquidity ought to be considered a core service of the corporate system, and if so, what steps should be taken, and by whom, to preserve and strengthen corporates' ability to offer that service? For example, should NCUA consider limiting a corporate's ability to offer other specific types of products and services in order to preserve and defend the liquidity function? What specific types of products and services should corporates be authorized to provide? NCUA is considering additional cash flow measuring requirements to assist corporates in achieving and maintaining proper liquidity. In this respect, comment is specifically solicited on the question of whether NCUA should add aggregate cash flow duration limitations to Part 704. If so, commenters are invited to describe how this requirement should be structured, and also to identify how such limitations would benefit liquidity management. Finally, comment is solicited on the question of what cash flow duration limits would be appropriate for corporate credit unions, particularly in an evolving interest rate market with previously unseen credit risk spreads.

**Field of Membership Issues.** NCUA also seeks comment on whether and how to restructure the corporate credit union system. For example, despite its intention of fostering competition, NCUA's decision to allow corporates to have national fields of membership (FOMs) may have resulted in significant, and unforeseen, risk taking. For example, corporates have competed with each other to offer higher rates, and have done so through the accretion of credit and marketability risks. To address this development, should the agency return to defined FOMs, for example, state or regional FOMs?

**Expanded Investment Authority.** At present, Part 704 provides for an option by which corporates meeting certain criteria can qualify for expanded investment authority. For example, a corporate meeting the criteria set out under Part One of the expanded authority is allowed to purchase investments with relatively lower credit ratings than otherwise permissible under the rule. NCUA seeks comment, first, as to whether the need for expanded authorities continues to exist. If so, should NCUA modify the procedures and qualifications, such as higher capital standards, by which corporates currently qualify for expanded authorities? If so, what should the new standards be? Should NCUA reduce the expanded authorities available? If so, which ones? Alternatively, should any of the limits in existing expanded authorities be reduced or increased? If so, which ones? Once granted, should NCUA require periodic requalification for expanded authorities? If so, what should be the timeframe?

**Structure; two-tiered system.** Over time, the corporate system has evolved into two tiers: a retail network of corporates that provide products and services to natural person credit unions, and a single, wholesale corporate that exclusively services the retail corporates. NCUA solicits comment about whether the two-tier corporate system in its current form meets the needs of credit unions. Specifically, NCUA seeks input from commenters about

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*whether there is a continuing need for a wholesale corporate credit union. If so, what should be its primary role? Should there be a differentiation in powers and authorities between retail and wholesale corporates? In considering these issues, commenters are specifically asked to consider whether the current configuration results in the inappropriate transfer of risk from the retail corporates to the wholesale corporate. Commenters should also address whether, assuming the two-tiered system is retained, capital requirements and risk measurement criteria (e.g., NEV volatility), as well as the range of permissible investments, for the wholesale corporate credit union should be different from those requirements that apply to a retail corporate credit union.*

### **Iowa Corporate's Response(s)**

#### **Payment System**

**Iowa Corporate believes that payment system services cannot be separated from other services. There are alternative ways in addressing the risk associated with a Corporate's ability to fund settlement activity. The risk is associated with liquidity concerns around overnight and intra-day settlement needs.**

**Corporates continue to be the primary financial institution for many credit unions and are valued to help mitigate payments risk and ease operational activities. The services provided by a primary financial institution must be all-inclusive in providing settlement services, payment services, investment and lending options. If one of these services is excluded credit unions would have to move outside of the Corporate Network to find the services and may find challenges in eligibility for services and prohibitive costs.**

**In providing payment and settlement services operational risk should be quantified and supported by adequate capital. Corporates should ensure appropriate amounts of capital to support underlying risks associated with all lines of business including; settlement services, payment services, deposits, and lending. Appropriate risk mitigation strategies and capital levels can be verified through the regular examination process.**

**In time Corporates could work together to provide payment services. If the current system is condensed from two to one tier Corporates could join together to form a CUSO to handle the operations of the payments. That way Corporates would only need to offer and settle products not necessarily run the operations. This is something that could be decided among the Corporates. Many Corporates have developed very competitive in house services and expert staffs that could be expanded to other Corporates. The consolidation of payment systems within the network may improve profitability, increase capital accumulation and reduce fees to members.**



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### **Liquidity and Liquidity Management**

**Liquidity must continue to be a core service of the Corporate System.**

The current unprecedented economic decline has caused a credit and liquidity crisis that far exceeds any that have been incorporated into planning and modeling scenarios for financial institutions. Corporates have managed liquidity well in the past and continued to provide solutions to members to assist in their liquidity needs. Even during the most recent economic decline Corporates have successfully weathered the decreases in deposits without selling investment securities due to an illiquid market.

Today's environment has revealed a need to more closely monitor and manage liquidity and cash flow as a Corporate Network. Corporates are required to maintain and monitor liquidity plans which have been effective. The current economic downturn has highlighted the need to employ additional avenues for the facilitation of the liquidity role. Corporates should consider more complex liquidity planning that includes several sources for borrowing and appropriate cash reserves. Corporates need to estimate future cash flows, incorporating a "margin of error" and securing adequate external borrowing sources.

Corporates should properly designate and isolate a portion of liquid funds for daily settlement that would take into account daily, monthly, and annual settlement activity levels. Corporates should require minimum reserve balances from member credit unions relative to their settlement activity that can be adjusted periodically. The Iowa Corporate currently uses this practice.

### **Field of Membership Issues**

The change to national fields of membership provided additional competition as well unintended risk. Although natural person credit unions benefited from better rates and a wider variety of product offerings, Corporates were also slower to accumulate capital. There was a shift in the cooperation and trust of the Corporate Network as they were now competitors. This lack in cooperation and trust led to waning support of shared resources including services provided by US Central.

One approach presented in the ANPR to reduce competition is to eliminate national FOMs and to "regionalize" Corporate membership. An alternative for consideration would be for natural person credit unions to be required to capitalize a Corporate in order to receive services. In order for this concept to work capital requirements would need to be similar from Corporate to Corporate.

### **Expanded Investment Authority**

Corporates are currently allowed to purchase only highly rated securities. Regulations had been adequate until the current economic downturn. Expanded investment authorities available to certain

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Corporates vary based on level and include additional investment options that provide diversification and potentially increased yield. These additional authorities also come with additional risk exposure.

Although the regulations give specific authorities based upon a Corporate's capital, risk profile, and expertise, more guidance is needed for appropriate and increased capital levels for expanded authorities.

The NCUA should consider more extensive reviews of Corporates with expanded authorities. This is in line with risk based examinations of the Corporate Network.

### Structure: Two-Tiered System

The current two tiered structure of the Corporate System centralizes resources and talent but also creates strains on capital accumulation. In time the Corporate Network should go from two tiers to a single tier.

The strains on capital occur as the capital risk assumed by US Central is considered. Current regulations call for a lower capital requirement for the Wholesale Corporate credit union however they hold a larger share of the credit risk. Iowa Corporate believes there is value in moving towards a structure where certain resources and expertise remain aggregated at the wholesale level but investments occur at the individual Corporate level.

Irrelevant to the number of Corporates there are several services and functions that could be consolidated for greater efficiency. This consolidation could be accomplished through a CUSO. Some examples of functions that could be centralized include: payments, core processing, risk modeling, call centers, and investment brokerage services.

## 2. CORPORATE CAPITAL

### ***ANPR Issue Description and Questions***

NCUA is considering revising various definitions and standards for determining appropriate capital requirements for corporate credit unions. For example, the agency could establish a new required capital ratio consisting only of core capital excluding membership capital accounts as a component of regulatory capital; the agency could also determine to increase the required capital ratio to more than four percent. The agency could also establish a new ratio based on risk-weighted asset classifications, which could include some form of membership capital. These changes would bring the corporate capital requirements more into line with standards applied by other federal financial regulators, such as the Comptroller of the Currency and the Federal Deposit Insurance Corporation (recognizing, however, that there are other accounting differences that apply with respect to the calculation of regulatory capital for banks). Another issue under consideration is whether to require a certain level of contributed capital from any natural person credit union seeking either membership or services from a corporate.

Core capital. The Board is considering several issues relating to the agency's approach to core capital (i.e., the traditional "tier one capital" definition as used by the several federal financial institution regulators). Under the current rule, core capital is defined as retained earnings plus paid-in capital. 12 CFR 704.2. Comment is invited



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concerning whether NCUA should establish a new capital ratio that corporates must meet consisting only of core capital, and if so, what would be the appropriate level to require. Commenters should offer their view concerning what actions are necessary to enable corporates to attain a sufficient core capital ratio as described above, as well as their thought about what would be an appropriate time frame for corporates to attain sufficient capital. The Board invites comment also on the question of what is the appropriate method to measure core capital given the significant fluctuation in corporate assets that occur. Commenters are invited to offer their view on the correct degree of emphasis that ought to be placed on generating core capital through undivided earnings. Finally, NCUA is considering whether to require that a corporate limit its services only to members maintaining contributed core capital with the corporate. Commenters are invited to react to that idea, and to offer any other suggestions or comments relative to the issue of core capital for corporates.

Membership capital. The Board is also considering several issues involving membership capital. 12 CFR 704.3(b). Issues under consideration and for which comment is sought include whether NCUA should continue to allow membership capital in its current configuration, or should the agency eliminate or modify certain features, such as the adjustment feature, so that membership capital meets the traditionally accepted definition of tier two capital. Other questions include whether to tie adjusted balance requirements, as set out currently in §704.3(b)(8), only to assets, as well as whether to impose limits on the frequency of adjustments. The agency is considering whether to require that any attempted reduction in membership capital based on downward adjustment automatically result in the account being placed on notice, within the meaning of current §704.3(b)(3), so that only a delayed payout after the three-year notice expires is permissible. Comment is also sought on whether to require that any withdrawal of membership capital be conditioned on the corporate's ability to meet all applicable capital requirements following withdrawal. Comment is invited on all these issues and on any revisions NCUA should consider for the definition and operation of membership capital. Risk-based capital and contributed capital requirements. Comment is solicited with respect to the following issues pertaining to risk-based capital and contributed capital requirements. Should NCUA consider risk-based capital for corporates consistent with that currently required of other federally regulated financial institutions? What regulatory and statutory changes, if any, would be required to effectuate such a change? Should a natural person credit union be required to maintain a contributed capital account with its corporate as a prerequisite to obtaining services from the corporate? Should contributed capital be calculated as a function of share balances maintained with the corporate? What about using asset size?

### **Iowa Corporate's Response(s)**

The Corporate Network should move towards a system similar to Basel standards for determining capital requirements. Core capital (Tier One) should be defined in line with other financial regulators as reserves and undivided earnings (RUDE) and perpetual paid-in capital (PIC). A core capital minimum requirement of 4% should be obtained by year end 2010. The Corporate Network can build retained earnings over several years by consolidating certain functions/services, paying off borrowings, shrinking member deposits, and possibly obtaining perpetual PIC as necessary. Corporates operating with a higher risk profile will be required to maintain a higher core capital ratio.

The current requirement for measuring capital levels using 12-month daily average net assets is appropriate as it considers seasonal fluctuations in assets.

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Membership capital shares were intended to provide funding for products and services and continue to serve a purpose in providing capital in addition to PIC. Network wide current membership capital shares are needed to support capital levels. When a Corporate reaches the revised requirement for core capital the membership capital shares could be returned to members at the Corporate's discretion without the three year notice period. Distribution of membership capital shares would continue to require NCUA approval.

To date membership capital share deposits have been tied to asset size and have carried a cap. A better way to determine membership capital levels may be to determine a usage calculation for members. That way the credit unions that are the heaviest users of corporate products and services would also be the highest contributors of capital.

Risk based capital regulation should be implemented to create parity with other financial institutions.

### 3. PERMISSIBLE INVESTMENTS

#### *ANPR Issue Description and Questions*

*NCUA is considering whether the corporate investment authorities should be constrained or restricted. Presently, corporates have the authority to purchase and hold investments that would not be permissible for natural person FCU members under Part 703 (or, in some cases, outside of what is authorized for a state chartered credit union). This increases a corporate*

*member's exposure to these risks commensurate with their level of investment in the corporate. Questions on which comment is solicited in this context include whether NCUA should limit corporate credit union investment authorities to those allowed for natural person credit unions. NCUA is also considering whether to prohibit certain categories of, or specific, investments, for example: collateralized debt obligations (CDOs), net interest margin securities (NIMs), and subprime and Alt-A asset-backed securities. Comment is solicited on that issue, as well as on whether NCUA should modify existing permissibility or prohibitions for investments.*

#### **Iowa Corporate's Response(s)**

**Liquidity must continue to be a core service of the Corporate System. For this reason Corporates should focus on liquid and short term investments. Corporate balance sheets require wider ranges of short-term investment offerings than those of natural person credit unions.**

**The following investments are specifically referenced in the ANPR and should not be permissible for Corporate credit union investments: collateralized debt obligations, net interest margin securities and subprime asset backed securities.**



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#### 4. CREDIT RISK MANAGEMENT

##### **ANPR Issue Description and Questions**

*The reliability of credit ratings for investments has become more questionable in light of events in the financial industry and the current absence of regulatory oversight for rating organizations. Consequently, NCUA is considering curbing the extent to which a corporate may rely on credit ratings provided by Nationally Recognized Statistical Rating Organizations (NRSROs). Comment is requested on whether NCUA should require more than one rating for an investment, or require that the lowest rating meet the minimum rating requirements of Part 704. NCUA also solicits comment on whether to require additional stress modeling tools in the regulation to enhance credit risk management. Several specific aspects of this issue are under consideration, for which comment is solicited, including whether Part 704 should be revised to lessen the reliance on NRSRO ratings. Commenters are invited to identify any other changes they believe may be prudent to help assure adequate management of credit risk. In this respect, commenters should consider whether Part 704 should be revised to provide specific concentration limits, including sector and obligor limits. If so, what specific limits would be appropriate for corporate credit unions? Comments are also solicited on the question of whether corporates should be required to obtain independent evaluations of credit risk in their investment portfolios. If so, what would be appropriate standards for these contractors? Another issue under consideration is whether corporates should be required to test sensitivities to credit spread widening, and if so, what standards should apply to that effort.*

##### **Iowa Corporate's Response(s)**

**Current Corporate regulation places too much emphasis on ratings of investment securities. This was used as the primary measurement for the evaluation of risk associated with investments until recent events. These ratings falsely identified the risks associated with certain investments in Corporates' portfolios. Ratings were not the only measurement used to in the evaluation of investment securities. Internal modeling, historical performance of asset types, and industry experts forecasts were also used in the evaluation of purchases of investment securities. Until the rating agencies are more heavily regulated and gain more credibility rating agency information on securities should not be the primary metric.**

**Rules should be established to limit and monitor cash flows and duration of investment securities to minimize deterioration of credit spreads similar to those that have occurred in the past two years. Concentration risks in certain sectors and diversification should be a primary focus for Corporates' investment portfolios and well defined in the regulations. Independent third parties as approved by regulators should perform evaluations of credit risk in Corporate credit unions portfolios. This should not be required for all Corporates as those with limited exposure and investments would be incurring undue additional expenses.**

#### 5. ASSET LIABILITY MANAGEMENT

##### **ANPR Issue Description and Questions**

*In a previous version of its corporate rule, NCUA required corporate credit unions to perform net interest income modeling and stress testing. Because one of the problems leading to the current market dislocation is a widening of*

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*credit spreads, the agency is considering re-instating this requirement. Alternatively, the agency may consider some form of mandatory modeling and testing of credit spread increases. Comment is solicited on whether NCUA should require corporates to use monitoring tools to identify these types of trends, including specifically comments about tangible benefits, if any, that would flow from these types of modeling requirements.*

### **Iowa Corporates Response(s)**

**Corporates with a certain percentage of assets in investment securities should model projected net interest income. This should not be required for all Corporates as those with limited exposure and investments would be incurring undue additional expenses. Corporates should continue to monitor NEV as part of their monthly risk modeling and monitoring processes.**

**Corporates with a certain percentage of assets in investment securities should perform modeling and testing of credit spread increases.**

## **6. CORPORATE GOVERNANCE**

### ***ANPR Issue Description and Questions***

*The sophistication and far-reaching impact of corporate activities requires a governing board with appropriate knowledge and expertise. NCUA is considering minimum standards for directors that would require a director possess an appropriate level of experience and independence. The agency is also considering term limits, allowing compensation for corporate directors, and requiring greater transparency for executive compensation. Comment is sought on all these issues. In addition, commenters are invited to respond to the question of whether or not the current structure of retail and wholesale corporate credit union boards is appropriate given the corporate business model. Should NCUA establish more stringent minimum qualifications and training requirements for individuals serving as corporate credit union directors? If so, what should the minimum qualifications be? NCUA is also considering whether to establish a category of "outside director," i.e., persons who are not officers of that corporate, officers of member natural person credit unions, and/or individuals from entirely outside the credit union industry. Commenters should offer their view on whether that approach is wise, and, if so whether NCUA should require that corporates select some minimum number of outside directors for their boards. Should a wholesale corporate credit union be required to have some directors from natural person credit unions? Comment is sought on whether NCUA should impose term limits on corporate directors, and, if so, what the maximum term should be. Comment is also sought on whether corporate directors should be compensated, and, if so, whether such compensation should be limited to outside directors only. Another issue under consideration, for which reaction from commenters is sought, is whether NCUA should allow members of corporate credit unions greater access to salary and benefit information for senior management.*

### **Iowa Corporate's Response(s)**

**Each Corporate's minimum qualifications of experience for Board and Committee members should be relevant to the services and activities of the particular Corporate. Each Corporate should be allowed**

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to decide the following as is suitable to their business: whether the board will comprise of outside directors, appropriate term limits, and compensation of directors. In regards to Corporate senior management salary and benefit information, Corporates should follow the same standards as credit unions.

Thank you once again for the opportunity to comment. If you have questions regarding any of the items above, please contact me at (515) 457-5222 or [saraf@iowacorporate.org](mailto:saraf@iowacorporate.org).

Sincerely,

Sara Flynn  
President/Chief Executive Officer

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